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No. 03-638

IN THE

Supreme Court of the United States

LIBERTY MUTUAL INSURANCE CO.,
Petitioner,

v.

CALDWELL TRUCKING PRP GROUP,
Respondent.

On Petition for a Writ of Certiorari to the Supreme Court of New Jersey

REPLY BRIEF FOR PETITIONER

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REPLY BRIEF FOR PETITIONER

As the petition explained, this case raises the important question "whether there are any federal constitutional limits on the power of a state supreme court to nullify, retroactively, the unambiguous contractual rights of a private party." Pet. 2. That question lies at the heart of this case – and the petition for certiorari – but the brief in response of Caldwell Trucking PRP Group ("PRP") makes no attempt to address any element of it. That is, PRP does not deny that the non-cumulation clause at issue in the insurance contracts of petitioner Liberty Mutual Insurance Co. ("Liberty") is an unambiguous limitation on the liability that Liberty agreed, more than twenty years ago, to assume for multiple-year occurrences. PRP does not deny that the decision below nullifies that limitation. PRP does not deny that, in so doing, the decision imposes a wholly retroactive, manifold increase (from $1 million to more than $8 million) in the potential liability for which Liberty could now be financially responsible for a single occurrence. Finally, and most important, PRP does not even deny that, as a result of all the foregoing, the decision below raises serious questions about whether the federal Constitution constrains the decisionmaking processes of state courts in any respect.

Indeed, PRP's basic substantive response to the federal issues raised in the petition is that the Constitution simply does *not* impose any such constraints, leaving state courts free to revise private contracts in the name of public policy and to impose enormous retroactive monetary liabilities. State courts have such power, PRP says, simply because they are *courts*. Liberty, by contrast, recognizes that courts must have some leeway to mold the law as they apply it, but, in our view, the courts still must apply *the law*. The decision below is not law – it is an arbitrary and confiscatory exercise of raw state power. Liberty and its insured entered into contracts which explicitly limited the amount of risk accepted by Liberty for an injury that occurs over time. Twenty years

later, the State of New Jersey decided not to honor the deal the parties had made on the ground that more pollution would be cleaned up in the state had Liberty not limited its liability. Whether it is the act of the executive, the legislative, or the judicial branch of the state, the harm to Liberty is the same. Certiorari should be granted.

I. THE FEDERAL ISSUES RAISED IN THE PETITION ARE PROPERLY BEFORE THIS COURT

PRP's first response to the federal questions raised in the petition is to try to avoid them. This effort is unavailing.

This Court will consider a federal claim in a case seeking review of a state court judgment if the claim was properly presented to the state court that rendered the decision to be reviewed. *Adams v. Robertson*, 520 U.S. 83, 86 (1997) (per curiam). That standard has been met here. The Due Process and Takings issues raised in the petition were specifically argued in Liberty's motion for reconsideration before the New Jersey Supreme Court. *See* Pet. App. 58a-65a. This Court has long recognized that "[t]here is no doubt that the federal claim was timely if the ruling of the state court could not have been anticipated and a petition for rehearing presented the first opportunity for raising it." *Herndon v. Georgia*, 295 U.S. 441, 444 (1935). The federal questions presented in the petition were raised only because the New Jersey Supreme Court did what it had always said it would never do – rewrite an insurance contract by retroactively voiding an unambiguous liability limitation in that contract in order to maximize coverage. And certainly no decision had ever done so twenty years after the policies had expired, undoing expectations settled literally for decades.

In 1976, when Liberty issued the first of the insurance policies at issue, it had "long been the law of [New Jersey] that the court is bound to enforce the policy as it is written." *Flynn v. Hartford Fire Ins. Co.*, 370 A.2d 61, 63-64 (N.J. Super., App. Div.), *certif. denied*, 379 A.2d 236 (N.J. 1977).

This fundamental principle was consistently applied in a long line of New Jersey cases throughout the period of Liberty's coverage up to the decision of the court below. These decisions recognized that courts "cannot ... write for the insureds a better insurance policy than the one bargained for and purchased." *Id.* Consistent with this rule, New Jersey courts had "adhered to the principle that an insurance policy should generally be interpreted 'according to its plain and ordinary meaning,' ... so as not to disregard the 'clear import and intent' of a policy exclusion" or provision. *American Motorists Ins. Co. v. L-C-A Sales Co.*, 713 A.2d 1007, 1013 (N.J. 1998) (internal citations omitted). Before the decision below, New Jersey courts understood that ignoring policy limitations "constitutes an unbargained-for expansion of coverage, *gratis*, resulting in the insurance company's exposure to a risk substantially broader than that expressly insured against in the policy." *Zuckerman v. National Union Fire Ins. Co.*, 495 A.2d 395, 406 (N.J. 1985).

As PRP notes, the decision below was explicitly based on *Owens-Illinois, Inc. v. United Ins. Co.*, 650 A.2d 974 (N.J. 1994). But as explained in the petition (Pet. 4-7, 13-4), nothing in *Owens-Illinois* suggested that courts were permitted to ignore contract language that directly addressed the handling of the claim at issue. To the contrary, the New Jersey Supreme Court acknowledged explicitly in *Owens-Illinois* that "[t]he source of any duty on the part of the Insurance Companies to defend actions or to pay any judgments is obviously in the contract of insurance." *Id.* at 978. As a result, the *Owens-Illinois* decision rested squarely upon its finding that the policy language under consideration in that case was simply inapplicable to allocation issues involving successive policies: "We are unable to find the answer to allocation in the language of the policies." *Id.* at 990. What the court in this case found controlling in *Owens-Illinois* was its reliance on a public policy of maximizing insurance coverage for environmental cleanup, Pet. App. 23a, even though

the *Owens-Illinois* Court actually found that "[a] rule of law premised on nothing more than the result-oriented goal of maximizing coverage has been described as judicial legislation. A more consistent principle is required." 650 A.2d at 981 (internal quotation marks omitted). In contrast to the decision below nullifying contractual language on the basis of such a public policy, the *Owens-Illinois* court had adverted to public policy as a basis for decisionmaking only after first finding that the insurance contract language did not answer the question at issue. *Id.* at 992.

Contrary to PRP's submission, the decision of the court below to retroactively nullify Liberty's non-cumulation clause on the basis of *Owens-Illinois* was *not* a predictable outcome, which Liberty should have anticipated by chocking its appellate briefs full of federal constitutional arguments. Before the decision below, the issue being litigated was not whether *Owens-Illinois nullified* the non-cumulation clause; the issue was how the clause should be *interpreted* in light of *Owens-Illinois*. This was because in setting out the continuous trigger theory, the *Owens-Illinois* court had stated that "when progressive indivisible injury or damage results from exposure to injurious conditions for which civil liability may be imposed, courts may reasonably treat the progressive injury or damage as an occurrence within each of the years of a CGL policy." *Id.* at 995. What the trial court held – and what PRP argued at both levels of appeal – was that the quoted statement constituted a definitive ruling that progressive property damage is to be treated as separate occurrences in each year of a triggered insurance policy, thus rendering the non-cumulation clause, which applies only when there has been a single occurrence, inapplicable by its terms. Thus the argument as presented to the courts by both sides was simply whether *Owens-Illinois* should be read as having determined that long-term environmental contamination must be treated as a separate, distinct occurrence in each year.

The New Jersey Supreme Court unexpectedly took the argument in a different direction. Although it mentioned the argument discussed above, Pet. App. 21a-22a, the court went out of its way to make clear that the true basis for its holding was that the non-cumulation clause was *unenforceable* "because it would thwart the *Owens-Illinois* pro-rata allocation modality," Pet. App. 22a: "Our *sole determination* in this case," the court stated, "is that Liberty's non-cumulation clause is unenforceable under *Owens-Illinois*." *Id.* at 24a (emphasis added); *see id.* ("the conflict between *Owens-Illinois* and Liberty's non-cumulation clause is the basis for our holding"). "Once the court turns to pro rata allocation [as it did in *Owens-Illinois* for the public policy reason of maximizing insurance coverage]," the court explained, a limitation on liability as fundamental as a non-cumulation clause must, as a matter of law, "drop[] out of the policy." *Id.* at 22a. The argument that the non-cumulation clause should simply be erased from the insurance contract, for the judicially created policy reason of increasing available insurance funds, had not previously been raised in the litigation. Accordingly, it was only when the New Jersey Supreme Court reached that unexpected and unprecedented conclusion that the federal issues presented here crystallized.[1] Liberty

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[1] To the extent the court expressed agreement with the view that the non-cumulation clause may be *interpreted*, consistent with *Owens-Illinois*, as not applying to this situation, those comments are not an independent ground for its judgment in this case. As noted, the court's central conclusion – its "sole determination" – is that *Owens-Illinois* forces the non-cumulation clause to "drop[] out of the policy." That conclusion rests on the ground that the public policy discussion in *Owens-Illinois* speaks to insurance policies with clear provisions establishing multiple-year occurrence liability limits. The conclusion that *Owens-Illinois* affects the *interpretation* of such provisions – as opposed to the underlying *enforceability* of such provisions – rests on the same ground. Thus, if the court had not reached its fundamental holding that *Owens-Illinois* simply nullified the non-cumulation clause, the court likely would not have found the clause to be inapplicable here.

promptly brought them to the attention of the New Jersey Supreme Court, which declined to revise its opinion or judgment. Liberty has now brought them before this Court, which has every right – and every reason – to hear them.

II. THE DECISION BELOW PRESENTS IMPORTANT FEDERAL ISSUES

PRP argues that because the decision below was "grounded exclusively in state court precedents and public policy considerations," Br. Opp. 12, it raises no federal issue worthy of review. The conclusion does not follow from the premise. Liberty has never denied that the decision below rests on state law and on the public policy of increasing funds available for environmental clean-up. But that is precisely the problem. It is equally true that a statute enacted by the legislature accomplishing the same confiscatory result as the decision below would be a "state law" based on "public policy." Such a statute obviously would present compelling federal questions. And the basic federal issue presented here is whether those federal questions are precluded merely because the decision below was issued by a panel of judges in court rather than enacted by legislators in session.

It is also wrong to say, as PRP does, that the decision below presents no conflict with decisions enforcing unambiguous contractual provisions because "the cases are legion in which unambiguous contract provisions are deemed unenforceable on public policy grounds." Br. Opp. 13. As PRP admits (*id.*), Liberty has never contended otherwise. We do not deny the "pervasiveness and acceptability of judicial review of private contracts," nor do we challenge "the right of courts to declare contractual provisions unenforceable in the public interest." Br. Opp. 14. The issue here is whether there is any limit whatsoever on the right of courts to do so.

The decision below did not declare the non-cumulation clause unenforceable because it required unlawful conduct, or because it imposed an unconscionable bargain between

insurer and insured, or because it imposed unfair obligations on the insured – all recognized bases for refusing to enforce contractual provisions as contrary to the public interest. And while courts also refuse to enforce contracts as being contrary to more ephemeral notions of "public policy," this Court has made clear that "public policy" does not give courts an open-ended license to rewrite private contracts:

> The general rule is that competent persons shall have the utmost liberty of contracting and that their agreements voluntarily and fairly made shall be held valid and enforced in the courts. . . . The principle that contracts in contravention of public policy are not enforceable should be applied with caution and only in cases plainly within the reasons on which that doctrine rests.
>
> . . . .
>
> [A contract] may not be held invalid, in the absence of a clear showing that some definite public interest will probably result from its performance.

Twin City Pipeline Co. v. Harding Glass Co., 283 U.S. 353, 356-58 (1931). In accordance with that rule, courts traditionally have tied refusals to enforce a contract on public policy grounds to some pre-existing, clearly settled public policy. For instance, courts long ago refused to enforce agreements to indemnify for the indemnitee's own acts of negligence because courts believed that shifting away financial liability for the consequences of negligent conduct would eliminate the deterrent effect of such liability and thereby encourage negligent acts. *See* W. Page Keeton et al., *Prosser & Keeton on the Law of Torts* § 82, at 585 (5th ed. 1984). Many courts today still refuse to enforce insurance policies as to acts of intentional misconduct for much the same reason. *See* Robert E. Keeton & Alan I. Widiss, *Insurance Law* § 5.4(d)(1), at 519 (1988). In either instance, the strong societal interest in deterring harmful conduct is a

"definite" public policy that courts could meaningfully apply in the enforcement of insurance contracts.

Here the asserted public policy is quite different: it is nothing more or less than an interest in making insurance companies pay more money to polluters, so that the latter can more easily cover the costs of the harms they have caused. As the petition demonstrates and PRP nowhere denies, the decision below is the same in substance as a decision holding that a clear $1 million liability limitation should be changed to $10 million, merely so the insurer can be made to pay ten times as much money toward environmental remediation. In other words, if the public policy identified in *Owens-Illinois* and applied here can support the nullification of the non-cumulation clause, then it should in theory be able to support nullification of *any* liability limitation. We are aware of no precedent anywhere applying "public policy" to so radically alter contractual obligations, and PRP cites none.

It is for these reasons that review of the decision below would not "open the floodgates" to review of state court decisions on state-law contract issues. Br. Opp. 15. Review here would, rather, serve as an important signal to state courts that, while considerations of public policy are and should be part of the common-law development of contract law, that process must remain one of *law*, not of confiscatory judicial legislating. On the other hand, the fact that the New Jersey Supreme Court decision is admittedly extreme should not insulate it from review on the ground that it is a "one-ticket, one-ride" decision with no broader consequences. As the amicus brief of the Complex Insurance Claims Litigation Association and the American Insurance Association confirms, the New Jersey Supreme Court's decision will have enormous effects on insurers in New Jersey and elsewhere. CICLA/AIA Br. 17. And the broader precedent it sets with respect to the power of courts to rewrite freely bargained, private contracts on the basis of public policy likely will be

felt even beyond the insurance industry. In short, it is very much the extreme and unprecedented nature of the decision that makes it so important, and the need for review so urgent.

III. THE DECISION BELOW VIOLATES THE DUE PROCESS AND TAKINGS CLAUSES

We need not at this jurisdictional stage belabor the merits of the federal questions presented by the decision below. Only a few points raised by PRP merit response.

PRP contends that the decision below does not contravene the Contracts Clause principles embedded in the Due Process Clause (Pet. 17-21) because the nullification of the non-cumulation clause was "'necessary' to serve a 'significant and legitimate public purpose.'" Br. Opp. 17 (quoting *Keystone Bituminous Coal Ass'n v. DeBenedictis*, 480 U.S. 470, 505 (1987)). PRP also suggests that there would be no Contracts Clause violation here if the decision below were an act of the New Jersey legislature because insurance is a "heavily regulated industry." *Id.* at 18. Both arguments prove too much: if the mere fact that a state wanted more money to pay for environmental clean-up or that insurance is a heavily regulated business sufficed to justify the egregious contractual impairment at issue here, then the Contracts Clause would impose no limits at all on such impairments.

Much the same is true for PRP's argument that the decision below does not constitute an unconstitutionally excessive and unfair imposition of retroactive monetary liability. We agree that due process "d[oes] not prohibit th[e] process of judicial evolution," Br. Opp. 20-21 (quoting *Rogers v. Tennessee*, 532 U.S. 451, 462 (2001)), but that is not the question here. The question is whether due process imposes any limits at all on the extent to which a court may, in the process of "fashioning and refining the law," *Rogers*, 532 U.S. at 462, completely unmake long settled contractual expectations. If the courts' power to apply an "evolving" law

suffices to justify the decision below, then, again, there are effectively no constitutional limits on that process at all.

While PRP appears to believe that due process imposes no constraints at all on the retroactive application of law newly made by state courts, PRP does argue that the decision below would not transgress such limits in any event, because a "fair reading of the line of decisions *starting with Owens-Illinois in 1994* leads to the conclusion that the New Jersey Supreme Court's decision was neither 'unexpected' nor 'indefensible' such that it offended due process." Br. Opp. 21 (emphasis added). Although we certainly disagree that *Owens-Illinois* foreshadowed the decision below, *see* Pet. 4-7, 13-14, PRP's argument misses a more fundamental point: whatever result may have been predictable *after Owens-Illinois* was decided in 1994, the contracts at issue here were completed *more than 10 years earlier*. Even PRP does not contend that, when the parties signed the insurance agreements at issue in this case, it was even remotely predictable that the New Jersey Supreme Court would declare the non-cumulation clause unenforceable more than a decade later.

Finally, PRP argues that the decision below does not violate the Takings Clause because the Clause is categorically inapplicable to state actions that only transfer money from one private party to the other, rather than take property for the public. Br. Opp. 23. That argument runs squarely contrary not only to *Eastern Enterprises v. Apfel*, 524 U.S. 498, 528 (1998) (plurality opinion), but also to this Nation's most settled constitutional traditions, *see Calder v. Bull*, 3 U.S. (3 Dall.) 386, 388 (1798) (opinion of Chase, J.) ("It is against all reason and justice" to presume that the legislature has been entrusted with the power to enact "a law that takes property from A. and gives it to B[.]"). The decision below contradicts those same traditions.

CONCLUSION

For the foregoing reasons, the petition should be granted.